

Healthsport, Inc.
Form 10-Q
August 23, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2010**

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number: 000-23100**

HEALTHSPORT, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

22-2649848
(I.R.S. Employer Identification No.)

1620 Beacon Place
Oxnard, CA
(Address of principal executive offices)

93033
(Zip Code)

(818) 593-4880

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of June 30, 2010, 122,582,717 shares of the issuer's common stock, par value \$0.0001 per share, were outstanding.

HealthSport, Inc.
Quarterly Report on Form 10-Q
For the Period Ended June 30, 2010
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EXPLANATORY NOTE

In this report, unless the context indicates otherwise, the terms HealthSport, Company, we, us, and our refer to HealthSport, Inc., a Delaware corporation, and its wholly-owned subsidiaries: InnoZen, Inc. (**InnoZen**); Enlyten, Inc. (**Enlyten**); Health Strip Solutions, LLC (**Health Strip**); and HealthSport Nutraceutical Products, Inc. (**Nutraceutical**).

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

Certain statements in this report, including information incorporated by reference, are forward-looking statements. Forward-looking statements reflect our current views about future events and financial performance based on certain assumptions. They include opinions, forecasts, intentions, plans, goals, projections, guidance, expectations, beliefs or other statements that are not statements of historical fact. Words such as may, will, should, could, would, plans, believes, anticipates, intends, estimates, approximates, predicts, or projects, and similar expressions identify a statement as a forward-looking statement. Any statements that refer to projections of our future financial performance, anticipated trends in our business, our goals, strategies, focus and plans, and other characterizations of future events or circumstances, including statements expressing general optimism about future operating results and the development of our products, are forward-looking statements. Forward-looking statements in this report may include statements about our ability to:

- maintain operating costs and implement our current business plan;
- obtain future financing or funds when needed;
- effectively launch new products;
- develop and obtain a diverse and loyal customer base;
- protect our intellectual property rights and avoid infringing on the rights of others;
- attract and retain a qualified employee base;
- respond to new technology developments before our competitors;
- successfully complete acquisitions, strategic partnerships, and other significant transactions; and
- develop and execute a successful business strategy.

The forward-looking statements in this report speak only as of the date of this report and caution should be taken not to place undue reliance on any such forward-looking statements. Forward-looking statements are subject to certain events, risks, and uncertainties that may be outside of our control. When considering forward-looking statements, you should carefully review the risks, uncertainties and other cautionary statements in this report as they identify certain important factors that could cause actual results to differ materially from those expressed in or implied by the forward-looking statements. These factors include, among others, the risks described under Item 1A and elsewhere in this report and in our 2009 Annual Report on Form 10-K, as well as in other reports and documents we file with the Securities and Exchange Commission.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS
HEALTHSPORT, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets**

	June 30, 2010 (unaudited)	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 43,043	\$ 1,205,945
Accounts receivable (less allowance of \$12,000 in 2010 and 2009)	63,650	64,726
Inventory, net	159,818	106,532
Prepaid expenses and other assets	108,320	200,757
Total current assets	374,831	1,577,960
Property and equipment, net	1,174,196	770,233
Patent costs and other intangible assets, net	7,782,338	10,832,424
Other assets	463,271	338,106
Total assets	\$ 9,794,636	\$ 13,518,723
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 1,450,916	\$ 1,575,116
Accrued expenses	574,344	651,865
Current portion of capital lease obligation	98,964	70,512
Current portion of convertible promissory notes, Note 5	1,554,096	1,409,450
Current portion of loan payable	65,095	
Deferred revenue	108,193	358,193
Stock subscription liability	394,000	536,222
Derivative liability		79,266
Total current liabilities	4,245,608	4,680,624
Convertible promissory notes, Note 5		144,646
Capital lease obligation	140,678	203,677
Total liabilities	4,386,286	5,028,947
Commitments and contingencies, Note 8		
Stockholders equity:		
Preferred stock: \$2.75 par value; authorized 2,000,000 shares; no shares issued and outstanding		
Common stock: \$0.0001 par value; authorized 500,000,000 shares; 122,582,717 and 122,082,717 shares issued and outstanding at June 30, 2010 and December 31, 2009, respectively	12,258	12,208

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Additional paid-in capital	77,667,346	77,511,178
Stock subscription receivable	(6,088,003)	(7,500,250)
Accumulated deficit	(66,183,251)	(61,533,360)
Total stockholders' equity	5,408,350	8,489,776
Total liabilities and stockholders' equity	\$ 9,794,636	\$ 13,518,723

See accompanying notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Operations (Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2010	2009	2010	2009
Revenue				
Product sales	\$	\$ 545,091	\$	\$ 2,153,250
License fees, royalties and services	250,000	18,750	250,000	77,500
Total revenues	250,000	563,841	250,000	2,230,750
Costs and expenses				
Cost of product sold and manufacturing costs	191,910	695,527	384,889	1,869,939
Selling, general and administrative expenses	871,594	5,117,717	4,303,197	6,300,320
Research and development costs	11,377	8,083	20,438	44,210
Total costs and expenses	1,074,881	5,821,327	4,708,524	8,214,469
Net loss from operations	(824,881)	(5,257,486)	(4,458,524)	(5,983,719)
Other income (expense):				
Interest income		10	75,036	298
Settlement income	35,529	440,331	42,132	440,331
Change in fair value of derivative liability		1,242,543	79,266	2,360,545
Other income	204		491	8,905
Other expense	(212,622)		(248,362)	
Loss on disposal of property & equipment	(9,147)		(16,923)	
Interest expense	(67,832)	(50,009)	(123,008)	(119,279)
Other income (expense)	(253,868)	1,632,875	(191,368)	2,690,800
Net loss before income taxes	(1,078,749)	(3,624,611)	(4,649,892)	(3,292,919)
Provision for income taxes				
Net loss	\$ (1,078,749)	\$ (3,624,611)	\$ (4,649,892)	\$ (3,292,919)
Net loss per share, basic and diluted	\$ (0.01)	\$ (0.07)	\$ (0.06)	\$ (0.06)
Weighted average shares outstanding, basic and diluted	79,487,487	51,272,490	76,052,296	51,107,906

See accompanying notes to condensed consolidated financial statements.

Table of Contents**HEALTHSPORT, INC. AND SUBSIDIARIES**
Condensed Consolidated Statements of Cash Flows (Unaudited)

	For the six months ended June 30,	
	2010	2009
Cash flows from operating activities		
Net loss	\$ (4,649,892)	\$ (3,292,919)
Adjustment to reconcile net loss to net cash used in operating activities:		
Interest income from stock subscription receivable	(75,000)	
Stock based compensation	45,385	358,911
Depreciation and amortization	417,443	669,083
Common stock issued for services	35,000	9,000
Reversal of stock based compensation	(142,222)	
Inventory obsolescence reserve		150,000
Asset impairment	2,792,880	4,000,000
Loss on sale of property & equipment	16,923	
Gain on debt settlement	(42,132)	(440,331)
Change in fair value of derivative liability	(79,266)	(2,360,545)
Change in other assets and liabilities:		
Accounts receivable	1,076	334,691
Inventory	(53,286)	66,296
Prepaid expenses and other assets	(173,035)	150,965
Accounts payable	(1,470)	17,895
Accrued expenses	(77,520)	(510,961)
Deferred revenue	(250,000)	156,480
Net cash used in operating activities	(2,235,116)	(691,435)
Cash flows from investing activities		
Patent costs incurred	(68,045)	(35,284)
Acquisition of property and equipment	(5,887)	(108,666)
Payments for construction-in-progress	(505,942)	
Deposits made on leasehold improvements	(15,000)	
Net cash used in investing activities	(594,874)	(143,950)
Cash flows from financing activities		
Collection of stock subscription receivable	1,934,855	
Repayment of stock subscription receivable	(237,085)	
Proceeds from loan		72,500
Loan repayments	(30,682)	
Capital lease payments		(31,818)
Sale of common stock		420,000
Net cash provided by financing activities	1,667,088	460,682

Net decrease in cash and cash equivalents	(1,162,902)	(374,703)
Cash and cash equivalents, beginning of period	1,205,945	433,573
Cash and cash equivalents, end of period	\$ 43,043	\$ 58,870

Supplemental cash flow information

Cash paid for interest and income taxes:

Interest	\$ 215,666	\$ 30,609
Income taxes		

Non-cash investing and financing activities:

Accounts payable applied to stock subscription receivable	115,145	
Common stock issued for consulting contracts		314,000
Common stock issued for notes payable and accrued interest		207,755
Common stock issued for rent payable		62,762

See accompanying notes to condensed consolidated financial statements.

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HealthSport, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 1: ORGANIZATION AND NATURE OF BUSINESS

Principles of Consolidation

The condensed consolidated financial statements include the accounts of HealthSport, Inc., a Delaware corporation, and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Financial Statement Preparation

The condensed consolidated financial statements included in this report have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting and include all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation. These condensed consolidated financial statements have not been audited.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to such rules and regulations for interim reporting. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009. The financial data for the interim periods presented may not necessarily reflect the results to be anticipated for the complete year.

Reclassification

Certain reclassifications of the amounts presented for the comparative period have been made to conform to the current presentation.

Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management makes estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Earnings Per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Common equivalent shares are excluded from the computation if their effect is anti-dilutive. Diluted earnings per share at June 30, 2010 and 2009 did not include outstanding stock options, warrants and convertible promissory notes because the effect would have been anti-dilutive.

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Nature of Business

We are a technology company specializing in the development and manufacture of proprietary, oral thin film products containing nutraceutical and pharmaceutical actives. We manufacture and distribute a number of dietary supplement products formulated to contain electrolytes, vitamins, melatonin, caffeine, and other supplements. We are also currently conducting research and development related to future potential products that will contain over-the-counter and prescription drug actives.

Our thin film, which for most applications is similar in size and shape to a postage stamp, dissolves rapidly and utilizes patent pending bi-layer technology and other novel processes, including proprietary micro-encapsulation methods to mask the taste of actives in the film products. The result of this superior technology is higher quality, more stable products that support a platform capable of carrying larger product volumes and a more diverse array of active ingredients. We believe these qualities render our thin film effective, easy to use and suited for a multitude of consumer products in both the dietary supplement and pharmaceutical arenas.

Going Concern

At June 30, 2010, we had current assets of \$374,831; current liabilities of \$4,245,608; and a working capital deficit of \$3,870,777. We incurred a loss of \$4,649,892 during the six months ended June 30, 2010, which included depreciation and amortization of \$417,443, a gain on change in fair value of derivative liability of \$79,266 and a \$2,792,880 impairment loss of intangibles. We have incurred substantial losses to date and have an accumulated deficit at June 30, 2010 of \$66,183,251.

We are not currently generating sufficient income or cash flow to fund our current operations. We did not generate any product sales during the six months ending June 30, 2010, as we transition to our new manufacturing facilities. We expect our facilities to be operational during the fourth quarter and plan to begin manufacturing and generating product sales at that time. However, we cannot predict with any degree of certainty the level of revenues we will be able to sustain. We are continually analyzing both our product costs as well as our operating costs in an effort to make additional cost reductions where possible. However, in order to support our current level of operations, substantial additional sales will be required. We expect that we will continue to generate losses from operations through the remainder of 2010.

Other than cash and cash equivalents and cash flow provided by operations, our primary source of working capital has been financing activities through the sale of debt or equity securities.

On December 1, 2009, we completed the sale of 66,666,667 shares (the Shares) of our common stock (the SMI Financing) to Supplement Manufacturing and Ingredients, LLC (SMI), pursuant to the Stock Purchase Agreement between the Company and SMI dated as of November 6, 2009, as amended on March 19, 2010 (the Amended Stock Purchase Agreement). In connection with the completion of the SMI Financing and in accordance with the Stock Purchase Agreement, SMI paid to the Company \$2,000,000 and issued a promissory note (the Promissory Note) to the Company in the amount of \$8,000,000. The Promissory Note, which was amended on March 19, 2010 (the Amended Promissory Note), will be payable in four installments as follows (refer to NOTE 9 for further details relating to the second amendment to the Promissory Note):

\$500,000 on or before November 15, 2009 (previously paid);

\$2,050,000 on or before May 15, 2010 (previously paid);

\$2,500,000 on or before July 15, 2010 (not yet paid);

\$2,950,000 on or before September 15, 2010; and

all remaining principal and interest due on September 15, 2010.

The Amended Promissory Note will mature on September 15, 2010 and amounts outstanding under the Amended Promissory Note bear interest at the rate of 4% per annum. We have issued a total of 30,333,333 of the shares to SMI under the Amended Stock Purchase Agreement. The remainder have been issued in the name of SMI but are being held pursuant to a stock pledge agreement, as amended on March 19, 2010 (the Amended Stock Pledge Agreement),

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pending receipt of payments under the Amended Promissory Note. The remaining balance due under the Amended Promissory Note has been recorded as a stock subscription receivable on the accompanying balance sheet.

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We are dependent upon receipt of payments from SMI under the Amended Promissory Note to continue our operations. If SMI were to suspend payments or default on their obligations under the Amended Promissory Note, we would not have sufficient capital to continue the build-out of our manufacturing facility or to conduct our operations. In such an event we would seek to raise additional capital through the sale of debt or equity securities. However, we do not have any such financing arrangements in place at this time, cannot provide any assurances that such financing would be available if needed, and do not know the terms upon which any such financing may be made available to us. On May 21, 2010, we entered into a merger agreement with SMI (the Merger Agreement) pursuant to which we agreed to combine with SMI if certain conditions are met. The Merger Agreement contemplates that, upon satisfaction of closing conditions, SMI will merge with and into our newly formed subsidiary HealthSport Subsidiary, LLC (HealthSport Subsidiary). HealthSport Subsidiary will survive the merger. Immediately following the merger, HealthSport Subsidiary will be renamed Supplemental Manufacturing & Ingredients LLC. As consideration for our acquisition of SMI, we will issue to the members of SMI a total of 251,257,841 shares of our common stock. The closing of the Merger Agreement is contingent upon the satisfaction of certain conditions, including SMI obtaining a commitment from a third party investor to invest \$10 million in HealthSport in exchange for shares of our common stock at a price equal to or greater than \$0.21 per share. Such commitment of investment by a third party must close concurrently with or immediately following the closing of the merger with SMI. We have the right to terminate the merger agreement if SMI is unable to obtain a commitment from a third party investor to invest \$10 million in HealthSport on the terms set forth in the merger agreement, as amended, by August 15, 2010. If the Merger Agreement closes, then at that time certain agreements between us and SMI would terminate including the Amended Promissory Note, the Amended Stock Purchase Agreement and the Amended Stock Pledge Agreement. These conditions raise substantial doubt about our ability to continue as a going concern. Because of our historic net losses and our negative working capital position, our independent auditors, in their reports on our financial statements for the years ended December 31, 2009 and 2008, expressed substantial doubt about our ability to continue as a going concern. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that could result from the outcome of this uncertainty.

Recent Accounting Pronouncements

In April 2009, the FASB issued guidance under ASC section 820, *Fair Value Measurements and Disclosures*, relating to required disclosures concerning the fair value of financial instruments when a publicly traded company issues financial information for interim reporting periods. The requirements are effective for interim reporting periods ending after June 15, 2009. The adoption of the new standard did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued guidance under ASC section 320, *Investments – Debt and Equity Securities*, modifying the requirements for recognizing other-than-temporarily impaired debt securities and significantly changing the existing impairment model for such securities. This guidance also modifies the presentation of other-than-temporary impairment losses. Such modifications include changing the amount of the other-than-temporary impairment that is recognized in earnings when there are credit losses on a debt security that the entity does not intend to sell and it is not more-likely-than-not that the entity will be required to sell prior to recovery. In these situations, the portion of the total impairment that is related to the credit loss would be recognized as a charge against operations, and the remaining portion would be included in other comprehensive income. The guidance also increases the frequency of and expands already required disclosures about the other-than-temporary impairment of debt and equity securities. This guidance is effective for fiscal years ending after June 15, 2009. As of the beginning of the period of adoption of this guidance, entities are required to recognize a cumulative-effect adjustment to reclassify the non-credit

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component of a previously recognized other-than-temporary impairment loss from beginning retained earnings to beginning accumulated other comprehensive income if the entity does not intend to sell the security and it is not more-likely-than-not that the entity will be required to sell the security before recovery. We adopted this guidance as of January 1, 2009. Since we did not hold any debt securities at January 1, 2009 that were the subject of previous other than temporary impairment charges which were non-credit in nature, the adoption of this guidance did not result in the recognition of a cumulative-effect adjustment. Adoption of this guidance did not have a material impact to our results of operations, financial condition, or liquidity.

In April 2009, the FASB issued guidance under ASC section 820, *Fair value Measurements and Disclosures*, which addresses the factors that determine whether there has been a significant decrease in the volume and level of activity for an asset or liability when compared to the normal market activity. This guidance provides that if it has been determined that the volume and level of activity has significantly decreased and that transactions are not orderly, further analysis is required and significant adjustments to the quoted prices or transactions might be needed. The guidance is effective for interim and annual reporting periods ending after June 15, 2009. Adoption did not have a material impact on our results of operations, financial condition, or liquidity.

In May 2009, the FASB issued guidance under ASC section 855, *Subsequent Events*, which establishes the standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. We adopted this standard, which did not have a material impact on our consolidated financial statements.

In June 2009, the Financial Accounting Standards Board (FASB) issued guidance as codified in ASC 810-10, *Consolidation of Variable Interest Entities* (previously Statement of Financial Accounting Standards (SFAS) No. 167, *Amendments to FASB Interpretation No. 46(R)*). This guidance is intended to improve financial reporting by providing additional guidance to companies involved with variable interest entities (VIEs) and by requiring additional disclosures about a company s involvement with variable interest entities. This guidance is generally effective for annual periods beginning after November 15, 2009 and for interim periods within that first annual reporting period. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In February 2010, the FASB issued ASU No. 2010-09, which updates the guidance in ASC 855, *Subsequent Events*, such that companies that file with the SEC will no longer be required to indicate the date through which they have analyzed subsequent events. This updated guidance became effective immediately upon issuance and was adopted as of the first quarter of 2010.

In March 2010, the FASB issued new accounting guidance, under ASC Topic 605 on *Revenue Recognition*. This standard provides that the milestone method is a valid application of the proportional performance model for revenue recognition if the milestones are substantive and there is substantive uncertainty about whether the milestones will be achieved. Determining whether a milestone is substantive requires judgment that should be made at the inception of the arrangement. To meet the definition of a substantive milestone, the consideration earned by achieving the milestone (1) would have to be commensurate with either the level of effort required to achieve the milestone or the enhancement in the value of the item delivered, (2) would have to relate solely to past performance, and (3) should be reasonable relative to all deliverables and payment terms in the arrangement. No bifurcation of an individual milestone is allowed and there can be more than one milestone in an arrangement. The standard is effective for interim and annual periods beginning on or after June 15, 2010. The Company is currently evaluating the impact the adoption of this guidance will have on its financial statements.

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Inventory at June 30, 2010 and December 31, 2009, consisted of the following:

	2010	2009
Raw materials	\$ 142,119	\$ 88,533
Work in progress	17,872	23,700
	159,991	112,233
Reserve for obsolescence	(173)	(5,701)
Total Inventory	\$ 159,818	\$ 106,532

NOTE 3: ASSET IMPAIRMENT

We continually monitor events and circumstances that could indicate carrying amounts of long-lived assets, including property, plant, equipment and intangible assets, may not be recoverable. When such events or changes in circumstances occur, we assess recoverability of long-lived assets, other than goodwill, by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the undiscounted future cash flows is less than the carrying amount of those assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the asset, or discounted estimated future cash flows if fair value is not readily determinable.

Due to a significant reduction in business volume and a decline in the quoted market price of our stock during the first quarter of 2010, management determined that the fair value of certain of our intangible assets had declined. Based on management's analysis, we recorded an impairment loss of \$2,792,880 for the net carrying value of some of our patents, trade secrets and web site in the first quarter of 2010, which is included in selling, general and administrative expenses in the statement of operations. We recorded an impairment loss of \$4,000,000 for the carrying value of goodwill during the second quarter of 2009, which is included in selling, general and administrative expenses in the statement of operations.

NOTE 4: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level Input:**Input Definition:**

Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs, other than quoted prices included in Level I, that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

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The following table summarizes fair value measurements by level at June 30, 2010 for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Cash and cash equivalents	\$ 43,043			\$ 43,043

Derivative liability

We have issued convertible secured notes in 2008. The convertible notes require us to record the value of the conversion feature as a liability, at fair value, pursuant to FASB accounting rules, including provisions in the notes that protect the holders from declines in our stock price, which is considered outside the control of the Company. The derivative liabilities are marked-to-market each reporting period and changes in fair value are recorded as a non-operating gain or loss in our statement of operations, until they are completely settled. The fair value of the conversion feature is determined each reporting period using the Black-Scholes option pricing model, and is affected by changes in inputs to that model including our stock price, expected stock price volatility, interest rates and expected term. The assumptions used in valuing the derivative liability during 2010 were as follows:

Risk free interest rate	0.45%
Expected life	0 - 0.5 years
Dividend Yields	0%
Volatility	121%

The following is a reconciliation of the derivative liability for 2010:

Value at January 1, 2010	\$ 79,266
Decrease in Value	(79,266)
Value at June 30, 2010	\$

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As of June 30, 2010, the Company was in default with several of our convertible promissory notes. Convertible promissory notes consisted of the following at June 30, 2010 and December 31, 2009:

	2010	2009
Senior secured convertible promissory notes of \$625,000 due March 31, 2010 with an option to extend for another 6 months at the discretion of the holders and \$450,000 due September 30, 2009; interest payable at 12% per annum and a default rate of 18% per annum; secured by technology and patent rights; principal and accrued interest convertible into common stock at \$0.15 per share (subject to adjustment if the Company sells stock or grants conversion rates at a lower price); accrued interest due on March 31, 2010 (13 holders) and accrued interest due on January 1, April 1, July 1 and Oct 1, 2009 (11 holders) paid through May 31, 2010	\$ 1,075,000	\$ 1,075,000
Convertible loan from Migami due September 22, 2009 with interest at 10% payable quarterly; secured; convertible into common stock at \$0.10 per share; interest due December 22, 2008, March 22, 2009 and June 22, 2009, principal and interest not paid due to litigation involving Migami and SMI Manufacturing, LLC (litigation does not involve the Company)	100,000	100,000
Convertible promissory note to an individual due December 24, 2010 including interest at 8% per annum; unsecured; convertible into common stock at \$0.15 per share; interest due February 1, 2009, not paid	48,000	48,000
Convertible promissory note to the Company's former counsel due April 11, 2011 including interest at 8% per annum; unsecured; convertible into common stock at \$0.15 per share; accrued interest due March 29, 2009, not paid	144,646	144,646
Convertible promissory note to a company due November 15, 2010 including interest at 12% per annum; unsecured; convertible into common stock at \$0.15 per share; accrued interest due monthly commencing December 1, 2008, not paid	51,450	51,450
Convertible promissory note to a company due December 24, 2010 including interest at 10% per annum; unsecured; convertible into common stock at \$0.20 per share; accrued interest due semi-annually commencing November, 21, 2009	112,500	112,500
Convertible promissory note to an individual dated October 21, 2008 and due October 21, 2009 including interest at 12% per annum; unsecured; convertible into common stock at \$0.15 per share, not paid	5,000	5,000
Convertible promissory note to a company due March 11, 2010 including interest at 6% per annum; unsecured; convertible into common stock at \$0.20 per share; accrued interest due March 11, 2010, not paid	2,500	2,500
Convertible promissory note to a company due April 30, 2010 including interest at 12% per annum; unsecured; convertible into common stock at \$0.15 per share; accrued interest due April 30, 2010	15,000	15,000
Note payable to a company due February 8, 2011 including interest at 7% per annum; principal and interest due monthly	51,702	
Note payable to a company due November 19, 2010 including interest at 7.25% per annum; principal and interest due monthly	13,393	
	1,619,191	1,554,096
Current portion of notes payable	1,619,191	1,409,450
Notes payable, less current portion	\$	\$ 144,646

Substantially all promissory notes are with shareholders.

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On April 30, 2010, we issued 4,000,000 common stock options to officers of the Company at an exercise price of \$0.09 per share that will expire on April 30, 2017. The fair value of the options on the date of grant was \$233,704 and was estimated by using the Black Scholes option valuation model. The following weighted-average assumptions were used for options granted during the six months ended June 30, 2010:

Expected term	4 years
Expected average volatility	102.24%
Expected dividend yield	0%
Risk-free interest rate	0.45%
Expected annual forfeiture rate	0%

NOTE 7: RELATED PARTY TRANSACTIONS

During the three months ended June 30, 2010, we entered into two consulting agreements with SMI, a majority shareholder, for construction management and cGMP management related to our new manufacturing facility in Oxnard, California. Monthly fees relating to the construction and cGMP management agreements are \$8,100 per month and \$10,417 per month, respectively. The term of the construction management agreement will end at the completion of our new manufacturing facility and the term of the cGMP management agreement is 12 months. During the three months ended June 30, 2010, \$32,400 and \$83,336 have been paid towards the construction and cGMP management agreements, respectively, of which \$52,085 has been prepaid towards the cGMP management agreement. We entered into several short-term loans totaling \$409,001 that are due on demand from SMI. These loans are recorded as part of the subscription receivable balance. As of June 30, 2010, the balance outstanding on the subscription receivable from SMI was \$6,088,003. Subsequent to June 30, 2010 and through August 13, 2010, SMI has paid \$343,350 towards the balance of the subscription receivable.

NOTE 8: COMMITMENTS AND CONTINGENCIES

We lease a 25,000 square foot manufacturing facility in Oxnard, California. The lease term is from December 1, 2007 through January 31, 2015 at lease rates of \$12,812 to \$14,853 per month.

We have a commission agreement with Hank Durschlag, our former CEO, which calls for us to pay Mr. Durschlag a commission of 0.5% of net sales revenues we received from the sale of dietary supplement/nutritional supplement edible film strip products for a period of seven (7) years and 50,000 shares of our unregistered stock for each \$1,000,000 in net sales revenues we receive on the sale of any and all dietary supplement/nutritional supplement edible film strip products up to a maximum of 500,000 shares.

We have a broker agreement with Jeffrey Wattenberg, our former President, which calls for us to pay Mr. Wattenberg a commission of 4% of the net sales revenues we receive for products and customers that Mr. Wattenberg brings to the Company and that we approve. In addition, Mr. Wattenberg will receive 75,000 shares of unregistered common stock of the Company for each \$1,000,000 in JV-attributable Sales that we receive under the terms of our July 2009 sales and distribution agreement with Destiny Productions and Content Marketing Solutions (Destiny) up to a maximum of 1,000,000 shares.

On March 11, 2008, we entered into a five-year distribution agreement with Perrigo Florida, Inc. (Perrigo), formerly known as Unico Holdings, Inc. Perrigo's customers include most of the largest retailers and distributors in the U.S. in each of these sales channels. The distribution agreement grants Perrigo certain exclusivity over its term, provided that Perrigo achieves minimum annual sales requirements totaling \$22 million during the term of the agreement.

On July 14, 2009, we entered into a sales and distribution agreement with Destiny. Under the terms of the agreement we agree to pay Destiny a commission for sales delivered by Destiny. In addition, we have agreed to advance to Destiny commissions in the amount of \$20,000 per month, subject to Destiny meeting certain minimum sales requirements. The advances are offset against commissions earned by Destiny under the agreement.

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Under the terms of an amendment to the Stock Purchase Agreement with SMI, we have committed to pay SMI for certain consulting fees of \$10,417 per month and \$8,100 per month in cash or shares of our common stock valued at \$0.15 per share. In the event that SMI's designees fail to constitute a majority of our board of directors for any reason, SMI has the right under the Amendment to demand payment of all unpaid consulting fees in cash and repayment of any expenses advanced for construction of the Oxnard facility under the Amended Promissory Note. In the event of such a demand, we have agreed to promptly deliver a short term promissory note to SMI evidencing our repayment obligation. Payments under the short-term note shall start no earlier than four months after SMI makes demand for payment. We have agreed to secure our payment obligation under the short term note with a lien on all of our assets subject to senior security interests. To the extent that we have previously released shares of common stock to SMI from the Stock Pledge Agreement on the basis of expenses advanced for our Oxnard facility, SMI will reconvey any such released shares to us for cancellation.

We have a capital lease obligation relating to manufacturing software. The lender has filed a complaint against us, which is more fully described below. As of June 30, 2010, \$27,319 of this obligation was reflected as an account payable. In addition to this amount, we could owe an additional \$45,137 over the balance of the capital lease.

We have failed to remit payroll tax payments of \$93,036, as required by various taxing authorities. When we make these payments, we expect that there will be various penalties and interest for the delayed payments. As of June 30, 2010, management was unable to estimate the amount of penalties and interest that we expect to incur as a result of these unpaid taxes.

At June 30, 2010, we were party to two significant litigation matters, the *Gatorade* matter and the *Kusher* matter, which we reported in previous public filings with the Securities and Exchange Commission. In the *Gatorade* matter, the parties entered into a stipulation of discontinuance on July 21, 2010 which effectively terminated the litigation by discontinuing the case on the merits with prejudice and without costs to any party as against the other. Other than as stated, there have been no material developments in the *Gatorade* or *Kusher* matters since last reported in our annual report on Form 10-K for the year ended December 31, 2009.

On February 10, 2009, Gary Thomas filed suit against the Company in the State of New York Supreme Court: Erie County. Mr. Thomas served as the Vice President of Sales for the Company's subsidiary, Enlyten, Inc. from on or around December 2006 until on or around June 2008. The complaint alleges breach of contract under a separation agreement entered into between Mr. Thomas and the Company. On May 4, 2010, judgment was entered in the action against the Company in the amount of \$211,842. The parties entered into an agreement not to enforce judgment that precludes Mr. Thomas from seeking to enforce such judgment in any manner prior to October 31, 2010.

On May 25, 2010, Bank of America Leasing & Capital, LLC filed suit against the Company in the Superior Court of the State of California for the County of Ventura. The complaint alleges damages of \$74,830 for breach of contract related to the Company's acquisition and financing of certain software and services. The Company intends to file a responsive pleading in this action and to defend the lawsuit.

On May 26, 2010, Fourth Street Holdings, LLC d/b/a Fourth Street Fund, LP filed suit against the Company in the Superior Court of Fulton County State of Georgia. The complaint alleges damages of only \$112,500 of principal and unpaid interest, which is accrued for as of June 30, 2010, for breach of an unsecured promissory note issued to the Company. On July 22, 2010, the Company filed an answer asserting multiple defenses.

On June 15, 2010, the Company filed suit against T. Lynn Mitchell Companies, LLC in the United States District Court for the Central District of California, Western Division. The complaint requests damages and injunctive relief for claims alleging breach of contract and breach of implied covenant of good faith and fair dealing relating to a trademark assignment agreement entered into between the parties. On July 28, 2010, T. Lynn Mitchell Companies filed a Notice of Motion and Motion to Dismiss for Lack of Personal Jurisdiction. On August 9, 2010, we filed plaintiff's opposition to defendant's motion to dismiss for lack of personal jurisdiction, or, in the alternative, request for limited jurisdiction of discovery. On August 17, 2010, we filed an amended complaint to add Enlyten, LLC as a defendant in the action.

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NOTE 9: SUBSEQUENT EVENTS

On July 14, 2010, we entered into amendments to the (i) Merger Agreement amongst us, HealthSport Subsidiary, LLC and SMI, (ii) the Promissory Note issued by SMI to us, and (iii) the Pledge Agreement between us and SMI. The amendment to the Merger Agreement extended the termination date of the Merger Agreement from July 15, 2010 to August 15, 2010 to provide more time for the parties to negotiate the proposed business combination and to secure the \$10 million financing. In accordance with the amendment to the Merger Agreement, we amended the Promissory Note and Pledge Agreement to provide that the due date for the \$2.5 million payment due from SMI to us on July 15, 2010 is extended to August 15, 2010.

As amended, the payments under the Amended Promissory Note are payable in four installments as follows:

\$500,000 on or before November 15, 2009 (previously paid);

\$2,050,000 on or before May 15, 2010 (previously paid);

\$2,500,000 on or before August 15, 2010 (not yet paid);

\$2,950,000 on or before September 15, 2010; and

all remaining principal and interest due on September 15, 2010.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Forward-Looking Statements

Statements in the following discussion and throughout this report that are not historical in nature are forward-looking statements. Please see Special Note Regarding Forward Looking Statements at the beginning of this report. The following discussion of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the related notes and other financial information appearing elsewhere in this report.

Overview

HealthSport is a technology company specializing in the development and manufacture of proprietary, oral thin film products for the delivery of nutritional supplements and pharmaceuticals.

A pioneer in the industry, we were the first company to deliver a drug active via oral thin film with the development of the Chloraseptic® Sore Throat Relief Strips® in June 2003. Utilizing our patent pending, bi-layer technology, we have proceeded to develop and launch a variety of dietary supplement and over-the-counter pharmaceutical thin film products, including those containing vitamins, minerals, electrolytes, sleep aids, caffeine, antioxidants and various over-the-counter drug actives.

Our thin film, which for most applications is similar in size and shape to a postage stamp, dissolves rapidly and utilizes patent pending bi-layer technology and other novel processes, including proprietary micro-encapsulation methods to mask the taste of actives in the film products. The result of this superior technology is higher quality, more stable products that support a platform capable of carrying larger product volumes and a more diverse array of active ingredients. We believe these qualities render our thin film effective, easy to use and suited for a multitude of consumer products in both the dietary supplement and pharmaceutical arenas. We are dedicated to improving the quality of life through innovative delivery technologies for pharmaceutical, nutraceutical and veterinary products.

We manufacture and distribute a number of nutritional supplement products formulated to contain electrolytes, vitamins, melatonin, caffeine, and other supplements. We are also currently conducting research and development related to future potential products that will contain over-the-counter and prescription drug actives.

Based on our existing portfolio of intellectual property, we believe there are significant potential opportunities to develop business with pharmaceutical companies. We believe our thin film technology can be used to create new, more effective drug products that should enjoy strong physician, patient and consumer acceptance. One unique opportunity involves using our technology to enable pharmaceutical companies to better manage the life cycle of their products. By combining our thin film delivery technology with existing drugs, we may be able to strategically differentiate existing or soon-to-be generic drugs from potential generic competitors or provide branded prescription products with additional patent protection or exclusivity in the marketplace.

Our strategic plan is to continue to make revolutionary advances in producing high-quality products that successfully address medical and consumer health needs while minimizing the risk of side effects.

Recent Developments

During the quarter ended June 30, 2010, we continued to focus on the development of our new manufacturing facility. Until December 2009, we operated a 9,500 square foot manufacturing facility in Woodland Hills, California. In December 2009, we relocated to a new 25,000 square foot facility in Oxnard, California. We are currently completing the build-out of our facility to become a fully operational, cGMP thin film manufacturing facility capable of producing both dietary supplement and over-the-counter drug products. The expected build-out completion date is September 15, 2010.

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In addition to our own new facility, we have entered into a manufacturing license agreement with SMI, pursuant to which SMI has agreed to manufacture certain products for us. SMI is currently constructing a 45,000 square foot, state-of-the-art, cGMP, thin film manufacturing facility in Tempe, Arizona that will be capable of producing both dietary supplement and pharmaceutical products. The facility is being designed and built to meet all domestic and international regulatory requirements and we believe will be capable of producing over 2 billion oral thin film strips annually. The projected completion date for the Tempe facility is March 31, 2011.

During the construction and development of these two facilities, we do not have manufacturing capabilities. We did not generate revenues for the six months ended June 30, 2010 and do not expect significant revenues for the third quarter of 2010 as we continue with facility construction. During this period, our sales efforts have been directed to identifying and engaging nationally and internationally recognized pharmaceutical and nutritional supplement companies with product lines that we believe are amenable to, and that can benefit from, our technology. We expect to have orders in hand that will let us generate revenues immediately following completion of our cGMP manufacturing facilities. However, we do not have any significant orders or backlog at this time.

We have funded our operations during this period from the proceeds of the sale of our common stock to SMI. On December 1, 2009, we entered into Securities Purchase Agreement with SMI (the Securities Purchase Agreement) pursuant to which we sold 66,666,667 shares of our common stock to SMI for an aggregate of \$10 million. To date we have received \$4,550,000 under this Agreement. The remaining amount due is represented by a promissory note (the Promissory Note). SMI's obligations under the Promissory Note are secured by a pledge of the shares under a stock pledge agreement (the Pledge Agreement). On March 19, 2010, we entered into amendments to the Securities Purchase Agreement, the Promissory Note and the Pledge Agreement to extend the payment terms for the final payment under the promissory note until September 15, 2010.

On May 21, 2010, we entered into a merger agreement with SMI (the Merger Agreement) pursuant to which we agreed to combine with SMI if certain conditions are met. The Merger Agreement contemplates that, upon satisfaction of closing conditions, SMI will merge with and into our newly formed subsidiary HealthSport Subsidiary, LLC (HealthSport Subsidiary). HealthSport Subsidiary will survive the merger. Immediately following the merger, HealthSport Subsidiary will be renamed Supplemental Manufacturing & Ingredients LLC. As consideration for our acquisition of SMI, we will issue to the members of SMI a total of 251,257,841 shares of our common stock.

The closing of the Merger Agreement is contingent upon the satisfaction of certain conditions, including SMI obtaining a commitment from a third party investor to invest \$10 million in HealthSport in exchange for shares of our common stock at a price equal to or greater than \$0.21 per share. Such commitment of investment by a third party must close concurrently with or immediately following the closing of the merger with SMI. We have the right to terminate the Merger Agreement if SMI is unable to obtain a commitment from a third party investor to invest \$10 million in HealthSport on the terms set forth in the merger agreement, as amended, by August 15, 2010. If the Merger Agreement closes, then at that time certain agreements between us and SMI would terminate including the Amended Promissory Note, the Amended Stock Purchase Agreement and the Amended Stock Pledge Agreement.

On July 14, 2010, we entered into amendments to the (i) Merger Agreement, the Promissory Note and the Pledge Agreement. The amendment to the Merger Agreement extended the termination date from July 15, 2010 to August 15, 2010 in order to provide more time for the parties to complete the negotiations of the proposed business combination and to secure the \$10 million in financing. The amendments to the Promissory Note and Pledge Agreement extended the due date for the \$2.5 million payment due from SMI to us on July 15, 2010 to August 15, 2010. As amended, the payments under the Amended Promissory Note are payable in four installments as follows:

\$500,000 on or before November 15, 2009 (previously paid);

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\$2,050,000 on or before May 15, 2010 (previously paid);

\$2,500,000 on or before August 15, 2010 (not yet paid);

\$2,950,000 on or before September 15, 2010; and

all remaining principal and interest due on September 15, 2010.

Comparison of the Three Months Ended June 30, 2010 to the Three Months Ended June 30, 2009

The following table sets forth certain selected condensed consolidated statement of operations data for the periods indicated:

	For the three months ended June	
	2010	30, 2009
Revenue		
Product sales	\$	\$ 545,091
License fees, royalties and services	250,000	18,750
Total revenues	250,000	563,841
Costs and expenses		
Cost of product sold and manufacturing costs	191,910	695,527
Selling, general and administrative expenses	871,594	5,117,717
Research and development costs	11,377	8,083
Total costs and expenses	1,074,881	5,821,327
Net loss from operations	(824,881)	(5,257,486)
Other income (expense):		
Interest income		10
Settlement income	35,529	440,331
Change in fair value of derivative liability		1,242,543
Other income	204	
Other expense	(212,622)	
Loss on disposal of property & equipment	(9,147)	
Interest expense	(67,832)	(50,009)
Other income (expense)	(253,868)	1,632,875
Net loss before income taxes	(1,078,749)	(3,624,611)
Provision for income taxes		
Net loss	\$ (1,078,749)	\$ (3,624,611)

Revenues

During the three months ended June 30, 2010, we did not generate any product sales; however, we did generate \$250,000 from license fees. We had sales of \$545,091 and revenue from license fees, royalties and services of

\$18,750, for a total of \$563,841 in the corresponding 2009 period. Revenues have significantly decreased during this period primarily due to our inability to manufacture products as we await completion of two state-of-the-art manufacturing facilities. One is our facility which is currently being constructed in Oxnard, California, and the second is currently under development and construction by our contract manufacturer, SMI, in Tempe, Arizona. During this construction phase, we are actively seeking additional distribution channels and revenue opportunities.

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Costs and Expenses

Since we did not generate any revenues during the three months ended June 30, 2010, we were not able absorb any of the fixed manufacturing costs incurred during this period. During the same period in 2009, we were not able to absorb all of our manufacturing costs due to the decrease in volume during the quarter. Sales will need to increase substantially to absorb all of the manufacturing costs at our current and anticipated level of manufacturing operations. Selling, general and administrative expenses (SG&A) decreased to \$871,594 in the three months ended June 30, 2010, from \$5,117,717 in the 2009 period. The decrease of \$4,246,123 in SG&A is the result of the following:

Because of the significant reduction in business volume and a decline in the quoted market price of our stock during the three months ended June 30, 2009, management determined that the fair value of our goodwill had declined. Based on management's analysis, we recorded an impairment loss of \$4,000,000 for the carrying value of our goodwill during the 2009 period. We did not record an impairment loss for the three months ended June 30, 2010.

Non-cash compensation expense was \$42,168 in 2010 and \$191,080 in 2009 and includes the amortization of the grant date fair value of stock options granted to employees, consultants and spokespersons over the relevant service periods. The decline is primarily the result of options expiring in the 2009 period as well as majority of stock options becoming fully vested during the 2009 period.

Depreciation and amortization expense decreased from \$335,634 in 2009 to \$183,888 in 2010, primarily as a result of the impairment loss of \$6,714,477 for the net carrying value of our patents, trade secrets and web site during the year ended December 31, 2009, which reduced the net carrying value of intangibles subject to amortization.

Selling and marketing costs were \$1,657 in the three months ended June 30, 2010, as compared to \$52,646 in the 2009 period, a decrease of \$50,989. The reduction is primarily due to a decrease in marketing and promotion expenses for products since we did not generate any revenues during the 2010 period.

We reduced corporate overhead and payroll, as well as decreased other SG&A costs due to the decrease in revenue and operations during the 2010 period.

Research and development (R&D) costs amounted to \$11,377 in 2010 and \$8,083 in 2009. These include contract services, supplies, materials and analytical testing costs incurred for new products. R&D expenses remain low due to limited available funding. As we secure additional working capital, we anticipate that R&D expenses will increase.

Other Income (Expense)

During the second quarter of 2009 we were able to settle a debt with a former customer which resulted in a gain of \$440,331. During the same period in 2010, we were able to settle debts with several of our vendors for a total gain of \$35,529.

We issued convertible secured notes in 2008. Certain provisions of the convertible notes require us to record the value of the conversion feature as a liability, at fair value, pursuant to FASB accounting rules, including provisions in the notes that protect the holders from declines in our stock price, which is considered outside the control of the Company. The derivative liability is marked-to-market each reporting period and changes in fair value are recorded as a non-operating gain or loss in our statement of operations, until they are completely settled. The fair value of the conversion feature is determined each reporting period using the Black-Scholes option pricing model, and is affected by changes in inputs to that model including our stock price, expected stock price volatility, interest rates and expected term. Based on the determination of the fair value of the derivative liability at the beginning of 2010 and 2009 and for the three months ended June 30, 2010 and 2009, we recognized a gain of \$0 and \$1,242,543, respectively, as the fair value of the derivative liabilities decreased.

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Included in other expense and accrued for as of June 30, 2010 is a court judgment entered against the Company in the amount of \$211,842 related to a lawsuit by a former employee. Please refer to Part II, Item 1 for further details.

Interest expense increased from \$50,009 in 2009 to \$67,832 in 2010 due to the Company paying a higher interest rate relating to our secured convertible promissory notes. These secured convertible promissory notes are currently in default.

Comparison of the Six Months Ended June 30, 2010 to the Six Months Ended June 30, 2009

The following table sets forth certain selected condensed consolidated statement of operations data for the periods indicated:

	For the six months ended June 30,	
	2010	2009
Revenue		
Product sales	\$	\$ 2,153,250
License fees, royalties and services	250,000	77,500
Total revenues	250,000	2,230,750
Costs and expenses		
Cost of product sold and manufacturing costs	384,889	1,869,939
Selling, general and administrative expenses	4,303,197	6,300,320
Research and development costs	20,438	44,210
Total costs and expenses	4,708,524	8,214,469
Net loss from operations	(4,458,524)	(5,983,719)
Other income (expense):		
Interest income	75,036	298
Settlement income	42,132	440,331
Change in fair value of derivative liability	79,266	2,360,545
Other income	491	8,905
Other expense	(248,362)	
Loss on disposal of property & equipment	(16,923)	
Interest expense	(123,008)	(119,279)
Other income (expense)	(191,368)	2,690,800
Net loss before income taxes	(4,649,892)	(3,292,919)
Provision for income taxes		
Net loss	\$ (4,649,892)	\$ (3,292,919)

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Revenues

During the six months ended June 30, 2010, we did not generate any product sales; however, we did generate \$250,000 from license fees. We had sales of \$2,153,250 and revenue from license fees, royalties and services of \$77,500, for a total of \$2,230,750 in the corresponding 2009 period. Revenues have significantly decreased during this period primarily due to our inability to manufacture products as we await completion of two state-of-the-art manufacturing facilities. One is our facility which is currently being constructed in Oxnard, California, and the second is currently under development and construction by our contract manufacturer, SMI, in Tempe, Arizona. During this construction phase, we are actively seeking additional distribution channels and revenue opportunities.

Costs and Expenses

Since we did not generate any revenues during the six months ended June 30, 2010, we were not able absorb any of the fixed manufacturing costs incurred during this period. However, during the same period in 2009, we were able to absorb all manufacturing costs. Sales will need to increase substantially to absorb all of the manufacturing costs at our current and anticipated level of manufacturing operations.

Selling, general and administrative expenses (SG&A) decreased to \$4,303,197 in the six months ended June 30, 2010, from \$6,300,320 in the 2009 period. The decrease of \$1,997,123 in SG&A is the result of the following:

Because of the significant reduction in business volume and a decline in the quoted market price of our stock during the six months ended June 30, 2010, management determined that the fair value of certain of our intangible assets had declined. Based on management's analysis, we recorded an impairment loss of \$2,792,880 for the net carrying value of some of our patents, trade secrets and web site during the 2010 period. We record an impairment loss of \$4,000,000 for the carrying value of our goodwill during the 2009 period.

Non-cash compensation expense was \$45,385 in 2010 and \$367,911 in 2009 and includes the amortization of the grant date fair value of stock options granted to employees, consultants and spokespersons over the relevant service periods. The decline is primarily the result of options expiring in the 2009 period as well as majority of stock options becoming fully vested during the 2009 period.

Depreciation and amortization expense decreased from \$669,083 in 2009 to \$417,443 in 2010, primarily as the result of the impairment loss of \$6,714,477 for the net carrying value of our patents, trade secrets and web site during the year ended December 31, 2009, which reduced the net carrying value of intangibles subject to amortization.

Selling and marketing costs were \$5,178 in the six months ended June 30, 2010, as compared to \$210,148 in the 2009 period, a decrease of \$204,970. The reduction is primarily due to a decrease in marketing and promotion expenses for products since we did not generate any revenues during the 2010 period.

We reduced corporate overhead and payroll, as well as decreased other SG&A costs due to the decrease in revenue and operations during the 2010 period.

Research and development (R&D) costs amounted to \$20,438 in 2010 and \$44,210 in 2009. These include contract services, supplies, materials and analytical testing costs incurred for new products. R&D expenses remain low due to limited available funding. As we secure additional working capital, we anticipate that R&D expenses will increase.

Other Income (Expense)

Interest income increased from \$298 during the six months ended June 30, 2009 to \$75,036 during the same period in 2010. The increase was primarily attributable to an accrued interest receivable from SMI stemming from the promissory notes issued in connection with the SMI Financing.

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During the six months ended June 30, 2009 we were able to settle a debt with a former customer which resulted in a gain of \$440,331. During the same period in 2010, we were able to settle debts with several of our vendors for a total gain of \$42,132.

We issued convertible secured notes in 2008. Certain provisions of the convertible notes require us to record the value of the conversion feature as a liability, at fair value, pursuant to FASB accounting rules, including provisions in the notes that protect the holders from declines in our stock price, which is considered outside the control of the Company. The derivative liability is marked-to-market each reporting period and changes in fair value are recorded as a non-operating gain or loss in our statement of operations, until they are completely settled. The fair value of the conversion feature is determined each reporting period using the Black-Scholes option pricing model, and is affected by changes in inputs to that model including our stock price, expected stock price volatility, interest rates and expected term. Based on the determination of the fair value of the derivative liability at the beginning of 2010 and 2009 and at June 30, 2010 and 2009, we recognized a gain of \$79,266 and \$2,360,545, respectively, as the fair value of the derivative liabilities decreased.

Included in other expense and accrued for as of June 30, 2010 is a court judgment entered against the Company in the amount of \$211,842 related to a lawsuit by a former employee. Please refer to Part II, Item 1 for further details.

Interest expense increased from \$119,279 in 2009 to \$123,008 in 2010 due to us paying a higher interest rate relating to our secured convertible promissory notes, which are currently in default. In addition, we were able to reduce interest charges relating to late payments as we are processing payments on a timelier basis during the six months ended June 30, 2010 compared to the previous period in 2009.

Liquidity, Capital Resources and Going Concern

Liquidity

At June 30, 2010, we had cash and cash equivalents of \$43,043, accounts receivable of \$63,650 and a working capital deficit of \$3,870,777. This compares to cash and cash equivalents of \$1,205,945, accounts receivable of \$64,726 and a working capital deficit of \$3,102,664 at December 31, 2009.

For the six months ended June 30, 2010, operating activities consumed \$2,235,116 of cash. This was primarily the result of a net loss for the year of \$4,649,892, offset by depreciation and amortization of \$417,443 and asset impairment of \$2,792,880.

Investment activities used an additional \$594,874 of cash during the six months ended June 30, 2010, primarily as a result of payments for patent costs, property and equipment, construction in progress and deposits made on leasehold improvements for the Oxnard facility.

Financing activities provided \$1,667,088 of cash during the six months ended June 30, 2010, primarily as the result from collection of our stock subscription receivable from SMI.

We are not currently generating sufficient income or cash flow to fund current operations. We did not generate any sales of product during the six months ended June 30, 2010. We are continually analyzing our current costs and are attempting to make additional cost reductions where possible. However, in order to support our current level of operations, substantial sales will be required. We expect that we will continue incurring losses from operations throughout 2010.

Capital Resources

Other than cash and cash equivalents and cash flows provided by operations, our primary source of working capital has been financing activities through the sale of debt or equity securities. We do not have any unused sources of credit presently available to us.

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We currently have \$450,000 of convertible promissory notes that were due by September 30, 2009 and an additional \$625,000 that were due by March 31, 2010. As of the date of this report, we do not have the funds to repay these convertible promissory notes. We plan to negotiate with the holders of those notes to extend the terms and to repay them from the proceeds of the SMI Financing and SMI merger. However, if we are unsuccessful in extending the term of the convertible promissory notes, or if we do not receive payment under the SMI Financing or SMI merger discussed below, we will not have the capital resources to repay the convertible promissory notes and their holders may bring action against us to collect on them.

On December 1, 2009, we completed the sale of 66,666,667 shares (the Shares) of our common stock (the SMI Financing) to SMI pursuant to the Stock Purchase Agreement. In connection with the completion of the SMI Financing and in accordance with the Stock Purchase Agreement, SMI paid to the Company \$2,000,000 and issued a promissory note (the Promissory Note) to the Company in the amount of \$8,000,000. The Promissory Note, which was amended on March 19, 2010 and on July 14, 2010 (the Amended Promissory Note), will be payable in four installments as follows:

\$500,000 on or before November 15, 2009 (previously paid);

\$2,050,000 on or before May 15, 2010 (previously paid);

\$2,500,000 on or before August 15, 2010 (not yet paid);

\$2,950,000 on or before September 15, 2010; and

all remaining principal and interest due on September 15, 2010.

The Amended Promissory Note will mature on September 15, 2010 and amounts outstanding under the Amended Promissory Note bear interest at the rate of 4% per annum. We have issued a total of 30,333,333 of the shares to SMI under the Securities Purchase Agreement. The remainder have been issued in the name of SMI but are being held in escrow, pending receipt of payments under the Amended Promissory Note. The remaining balance due under the Amended Promissory Note has been recorded as a stock subscription receivable on the accompanying balance sheet.

We are dependent upon receipt of payments from SMI under the Amended Promissory Note to continue our operations. If SMI were to suspend payments or default on their obligations under the Amended Promissory Note, we would not have sufficient capital to continue the build-out of our manufacturing facility or to conduct our operations. In such an event we would seek to raise additional capital through the sale of debt or equity securities. However, we do not have any such financing arrangements in place at this time, cannot provide any assurances that such financing would be available if needed, and do not know the terms upon which any such financing may be made available to us.

On May 21, 2010, we entered into the Merger Agreement with SMI pursuant to which we agreed to combine with SMI if certain conditions are met. The merger agreement contemplates that, upon satisfaction of closing conditions, SMI will merge with and into our newly formed subsidiary HealthSport Subsidiary. HealthSport Subsidiary will survive the merger. Immediately following the merger, HealthSport Subsidiary will be renamed Supplemental Manufacturing & Ingredients LLC. As consideration for our acquisition of SMI, we will issue to the members of SMI a total of 251,257,841 shares of our common stock.

The closing of the Merger Agreement is contingent upon the satisfaction of certain conditions, including SMI obtaining a commitment from a third party investor to invest \$10 million in HealthSport in exchange for shares of our common stock at a price equal to or greater than \$0.21 per share. Such commitment of investment by a third party must close concurrently with or immediately following the closing of the merger with SMI. We have the right to terminate the merger agreement if SMI is unable to obtain a commitment from a third party investor to invest \$10 million in HealthSport on the terms set forth in the merger agreement, as amended, by August 15, 2010. If the Merger Agreement closes, then at that time certain agreements between us and SMI would terminate including the Amended Promissory Note, the Amended Stock Purchase Agreement and the Amended Stock Pledge Agreement.

As of August 16, 2010, SMI has not made the August 15, 2010 payment under the Promissory Note and has not completed the conditions to the consummation of the Merger Agreement. The parties continue to work together in an

effort to complete the business combination. No other arrangements or commitments for any such financing are in place at this time, and we cannot give any assurances about the availability or terms of any future financing. We believe the recent worldwide financial crisis has significantly decreased the market for private financing. The number of investment funds committing capital to microcap issuers has decreased and costs for financing both debt and equity have increased.

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Going Concern

Because of our history of net losses and our negative working capital position, our independent auditors, in their reports on our financial statements for the years ended December 31, 2009 and 2008, expressed substantial doubt about our ability to continue as a going concern.

Recent Accounting Pronouncements

Please see the section entitled "Recent Accounting Pronouncements" contained in Note 1 "Organization and Nature of Business" to our financial statements included in Part I "Item 1. Financial Statements" of this report.

Off-Balance Sheet Arrangements

At June 30, 2010, we did not have any off-balance sheet arrangements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company we are not required to provide the information specified by this item.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that material information is: (1) gathered and communicated to our management, including our principal executive and financial officers, on a timely basis; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934, as amended.

Our management, with the participation of our chief executive officer and chief accounting officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2010. Based on such evaluation, our chief executive officer and chief accounting officer concluded that our disclosure controls and procedures were effective for their intended purpose described above.

Changes in Internal Controls Over Financial Reporting

In our annual report on Form 10-K for the year ended December 31, 2009, management reported on weaknesses that it identified in our internal control over financial reporting as of December 31, 2009. The matters involving internal controls and procedures that our management considered to be material weaknesses under the standards of the Public Company Accounting Oversight Board were:

lack of a functioning audit committee due to a lack of a majority of independent members and a lack of a majority of outside directors on our board of directors, resulting in ineffective oversight in the establishment and monitoring of required internal controls and procedures;

lack of a "whistleblower" policy for employees to report suspected internal control issues; and

inadequate segregation of duties due to the limited size of the accounting department and the lack of experienced accountants caused by the Company's limited financial resources.

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In an effort to remediate the identified material weaknesses and other deficiencies and enhance our internal controls, the Company appointed Mark Udell, a certified public accountant, as the principal accounting officer on March 19, 2010. Mr. Udell's appointment has partially addressed the issue of the lack of segregation of duties. In addition, Mr. Udell will oversee implementation of additional internal controls and procedures.

We plan to adopt corporate governance guidelines including a code of ethics and a whistleblower policy, but have not done so at this time. We also plan to appoint two or more independent directors to our board. We intend to identify and retain independent directors that would be qualified to serve as audit committee members.

No changes were made in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations of Internal Controls and Disclosure Controls and Procedures

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Table of Contents**PART II OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS**

From time to time, we may become involved in legal proceedings relating to claims arising out of our operations in the normal course of business. Litigation in general can be expensive disruptive to normal business operations and difficult to predict. An unfavorable resolution of one or more legal proceedings could have a material adverse effect on our business, results of operations or financial condition; moreover, the need to defend claims in such proceedings could require payments of legal fees that, given our financial condition, negatively impacts our ability to defend such claims. As of the date of this report, except as discussed below, we are not a party to any litigation which we believe would have a material adverse effect on our business operations or financial condition.

At June 30, 2010, we were party to two significant litigation matters, the *Gatorade* matter and the *Kusher* matter, which we reported in previous public filings with the SEC. In the *Gatorade* matter, the parties entered into a stipulation of discontinuance on July 21, 2010 which effectively terminated the litigation by discontinuing the case on the merits with prejudice and without costs to any party as against the other. Other than as stated, there have been no material developments in the *Gatorade* or *Kusher* matters since we last reported on them in our annual report on Form 10-K for the year ended December 31, 2009.

On February 10, 2009, Gary Thomas filed suit against the Company in the State of New York Supreme Court, Erie County. Mr. Thomas served as the Vice President of Sales for the Company's subsidiary, Enlyten, Inc. from on or around December 2006 until on or around June 2008. The complaint alleges breach of contract under a separation agreement entered into between Mr. Thomas and the Company. On May 4, 2010, judgment was entered in the action against the Company in the amount of \$211,842. The parties entered into an agreement not to enforce judgment that precludes Mr. Thomas from seeking to enforce such judgment in any manner prior to October 31, 2010.

On May 25, 2010, Bank of America Leasing & Capital, LLC filed suit against the Company in the Superior Court of the State of California for the County of Ventura. The complaint alleges damages of \$74,830 for breach of contract related to the Company's acquisition and financing of certain software and services. The Company intends to file a responsive pleading in this action and to defend the lawsuit.

On May 26, 2010, Fourth Street Holdings, LLC d/b/a Fourth Street Fund, LP filed suit against the Company in the Superior Court of Fulton County State of Georgia. The complaint alleges damages of only \$112,500 of principal and unpaid interest for breach of an unsecured promissory note issued by the Company. On July 22, 2010, the Company filed an answer asserting multiple defenses.

On June 15, 2010, the Company filed suit against T. Lynn Mitchell Companies, LLC in the United States District Court for the Central District of California, Western Division. The complaint requests damages and injunctive relief for claims alleging breach of contract and breach of implied covenant of good faith and fair dealing relating to a trademark assignment agreement entered into between the parties. On July 28, 2010, T. Lynn Mitchell Companies filed a motion to dismiss for lack of personal jurisdiction. On August 9, 2010, we filed plaintiff's opposition to defendant's motion to dismiss for lack of personal jurisdiction, or, in the alternative, request for limited jurisdiction of discovery. On August 17, 2010, we filed an amended complaint to add Enlyten, LLC as a defendant in the action.

Item 1A. RISK FACTORS

Investment in our common stock involves a high degree of risk. The risk factors set forth below update the risk factors in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 filed on March 31, 2010. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, projected results and future prospects. If any of these risks actually occur, our business, financial condition or results of operations could suffer. In that case, the value of our common stock could decline, and you may lose all or part of your investment. The risk factors described in our Annual Report on Form 10-K and below are not exhaustive. These risk factors represent only some of the risks associated with investment in our common stock.

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We currently do not have any arrangement for the manufacturing of our products and will not have revenue until we are able to complete our manufacturing facility in Oxnard, California or arrange for an alternative means of manufacturing our products.

Until December 2009, we operated a 9,500 square foot manufacturing facility in Woodland Hills, California. In December 2009, we completed relocation to a new 25,000 square foot facility in Oxnard, California. The plant is currently under design and construction to become a fully operational, cGMP film strip manufacturing facility capable of producing both dietary supplement and over-the-counter drug products. The expected construction completion date is September 15, 2010. Until such time as our new manufacturing plant is completed or we arrange for an alternative means for manufacturing our products, we are not able to manufacture or sell any of our products and will not generate any revenue. Although we anticipate that we will begin manufacturing our product after the expected completion date for our new manufacturing facility, there can be no assurance that the development of the manufacturing facility will not be delayed or that our new manufacturing facility will meet all of our needs when completed. In such case, and if we are not able to secure an alternative means for manufacturing our products, our financial condition and results of operations may be impaired.

We will require additional capital in order to fund our operating expenses, and if we fail to raise sufficient additional capital we may be forced to curtail or cease operations.

On December 1, 2009, we entered into a stock purchase agreement with SMI which provided for payment to us of \$10 million, \$2 million payable at closing and \$8 million under the terms of a Promissory Note. The Promissory Note called for installment payments to be made to us of the \$8 million. SMI has paid to us an aggregate of \$4,550,000. On March 19, 2010 and July 14, 2010, we entered into amendments to the Promissory Note and related agreements to restructure the payment obligations to us. Under the amended Promissory Note, SMI is to pay us \$2,500,000 on or before August 15, 2010 and \$2,950,000 on or before September 15, 2010. As of the date of this report, SMI has not made the August 15, 2010 payment under the Promissory Note. If SMI fails to make the installments payments under the amended Promissory Note, we will need to secure capital from other sources in order to continue our operations. Even if SMI makes the installment payments under its Amended Promissory Note, we expect to require further capital to execute our current business plan.

In addition, on May 21, 2010, we entered into a Merger Agreement with SMI pursuant to which we agreed to combine with SMI in a merger transaction if certain conditions are met. The closing of the merger agreement is contingent upon the satisfaction of certain conditions, including SMI obtaining a commitment from a third party investor to invest \$10 million in HealthSport in exchange for shares of our common stock at a price equal to or greater than \$0.21 per share. Such investment by a third party must close concurrently with or immediately following the closing of the merger with SMI. We have the right to terminate the merger agreement if SMI is unable to obtain a commitment from a third party investor to invest \$10 million in HealthSport on the terms set forth in the Merger Agreement, as amended, by August 15, 2010. If the Merger Agreement closes, then at that time certain agreements between us and SMI would terminate including the Amended Promissory Note, the Amended Stock Purchase Agreement and the Amended Stock Pledge Agreement. There can be no assurance that SMI will be able to obtain a commitment from a third party investor to invest in HealthSport on the terms set forth in the merger agreement or at all. Consequently, there can be no assurance that the merger contemplated by the merger agreement or any other merger involving HealthSport and SMI will take place.

Our ability to secure any other financing will depend upon a number of factors, including our financial condition, business operations and prospects, as well as general economic conditions, and conditions in the relevant financial markets. We cannot assure you that we will be able to secure financing, as needed, and if we cannot we will be forced to curtail or cease operations. Moreover, even if we identify a possible financing, the terms may not be favorable to us, or may involve substantial dilution to our existing stockholders.

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Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

We did not sell any shares of our common stock during the three months ended June 30, 2010.

Item 3. DEFAULTS UPON SENIOR SECURITIES.

We have secured convertible promissory notes outstanding at June 30, 2010 in the aggregate principal amount of \$1,075,000. Of this amount, notes in the aggregate principal amount of \$625,000 were due March 31, 2010, and notes in the aggregate principal amount of \$450,000 were due September 30, 2009. All of our outstanding secured convertible promissory notes are currently in default. The amount of accrued and unpaid interest under all of these secured convertible promissory notes at June 30, 2010 was \$27,973. However, as a result of the default, the holders of the secured convertible promissory notes have the right to demand payment in full of all amounts outstanding under those secured convertible promissory notes.

Item 4. (REMOVED AND RESERVED)

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS.

See the exhibit index immediately following the signature page of this report.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 23, 2010

HEALTHSPORT, INC.

By: /s/ Kevin Taheri
Kevin Taheri
Chief Executive Officer

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EXHIBIT INDEX

Exhibit No.	Document Description	Incorporation by Reference
4.1	Second Amendment to Promissory Note issued by HealthSport, Inc. to Supplemental Manufacturing & Ingredients, LLC dated July 14, 2010.	Incorporated by reference to the exhibits to the Company's report on Form 8-K filed with the SEC on July 15, 2010.
10.1	Merger Agreement Among HealthSport, Inc., HealthSport Subsidiary, LLC and Supplemental Manufacturing & Ingredients, LLC dated May 21, 2010.	Incorporated by reference to the exhibit to the Company's report on Form 8-K filed with the SEC on May 24, 2010.
10.2	Amendment to Merger Agreement Among HealthSport, Inc., HealthSport Subsidiary, LLC and Supplemental Manufacturing & Ingredients, LLC dated July 14, 2010.	Incorporated by reference to the exhibits to the Company's report on Form 8-K filed with the SEC on July 15, 2010.
10.3	Second Amendment to Pledge Agreement between HealthSport, Inc. and Supplemental Manufacturing & Ingredients, LLC dated July 14, 2010.	Incorporated by reference to the exhibits to the Company's report on Form 8-K filed with the SEC on July 15, 2010.
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith.